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No. 89-894

In the Supreme Court of the United States

OCTOBER TERM, 1989

MICHAEL J. CONNOLLY, SECRETARY OF STATE OF MASSACHUSETTS, ET AL., PETITIONERS

v.

SECURITIES INDUSTRY ASSOCIATION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Whether Section 2 of the Federal Arbitration Act, 9 U.S.C. 2, which provides that an arbitration agreement in "a contract evidencing a transaction involving commerce * * * shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract," precludes the Commonwealth of Massachusetts from adopting regulations concerned exclusively with arbitration provisions in contracts used to open securities brokerage accounts.

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This brief is submitted in response to the Court's order inviting the Solicitor General to express the views of the United States.

STATEMENT

1. Congress enacted the Federal Arbitration Act, 9 U.S.C. 1 *et seq.*, in order to "revers[e] centuries of judicial hostility to arbitration agreements" and to "place arbitration agreements 'upon the same footing as other contracts.'" *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 510-511 (1974) (quoting H.R. Rep. No. 96, 68th Cong., 1st Sess. 1, 1 (1924)). In order to accomplish that overarching purpose, the Act provides in Section 2 that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. 2. "In enacting § 2 of the federal Act," this Court has observed, "Congress declared a national policy favoring arbitration and withdrew the power of the states to require

a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Southland Corp.* v. *Keating*, 465 U.S. 1, 10 (1984). In other words, "Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements." *Id.* at 16 (footnote omitted).

In order to promote the "federal policy favoring arbitration," *Moses H. Cone Memorial Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983), the Federal Arbitration Act also provides that a court must stay its proceedings if it is satisfied that an issue before it is subject to an arbitration agreement under the Act, 9 U.S.C. 3. Moreover, the Act authorizes a federal district court to issue an order compelling arbitration if there has been a "failure, neglect, or refusal" to comply with such an agreement, 9 U.S.C. 4. See *Shearson/American Express Inc.* v. *McMahon*, 482 U.S. 220, 226 (1987).

2. In *Shearson/American Express Inc.* v. *McMahon*, *supra*, this Court held that agreements to arbitrate claims against brokerage firms under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), were "enforce[able] . . . in accord with the explicit provisions of the Arbitration Act," 482 U.S. at 238 (quoting *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 520).[1] In that decision's wake, the Secretary of State of the Commonwealth of Massachusetts took steps to regulate securities broker-

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[1] Before *Shearson/American Express Inc.* v. *McMahon*, *supra*, it was unclear whether agreements to arbitrate claims under either the Securities Exchange Act of 1934 or the Securities Act of 1933 were enforceable in light of *Wilko* v. *Swan*, 346 U.S. 427 (1953). See *Shearson/American Express Inc.* v. *McMahon*, 482 U.S. at 225 n.1. In *Wilko* v. *Swan*, *supra*, the Court had held that a pre-dispute agreement could not be enforced to compel arbitration of a claim arising under Section 12(2) of the Securities Act of 1933, 15 U.S.C. 77l(2).

The *McMahon* decision called into question the continued vitality of *Wilko* v. *Swan*. In *Rodriguez de Quijas* v. *Shearson/American Express, Inc.*, 109 S. Ct. 1917, 1922 (1989), the Court overruled *Wilko* v. *Swan*, holding that pre-dispute agreements to arbitrate claims against brokerage firms under the Securities Act of 1933 are enforceable under the Federal Arbitration Act.

dealers' use of pre-dispute arbitration provisions in contracts opening brokerage accounts.[2] Under Massachusetts law, broker-dealers must be registered with the Commonwealth in order to transact securities business. Mass. Gen. L. ch. 110A, § 201 (1985). The Secretary may "deny, suspend, or revoke" that registration upon finding that a broker-dealer "has engaged in dishonest or unethical practices in the securities business." Mass. Gen. L. ch. 110A, § 204(*a*)(G) (1985).

On September 21, 1988, after public hearing and comment, the Secretary amended the definition of proscribed "dishonest or unethical practices in the securities business" to take account of securities broker-dealers' use of pre-dispute arbitration provisions in contracts opening brokerage accounts. The Secretary declared that the purpose of the amended regulations was to "provide the customer with a meaningful choice prior to making a decision to sign the [arbitration] agreement." Mass. Reg. No. 593 (Oct. 14, 1988).

The amended regulations prohibited broker-dealers from engaging in the following practices as of January 1, 1989: (1) *requiring* customers (other than institutional investors or financial institutions) to "execute either a mandatory pre-dispute arbitration contract or a customer agreement containing a mandatory pre-dispute arbitration clause that is a non-negotiable precondition" to opening or transacting business in a securities account, Mass. Regs. Code tit. 950, § 12.204(G)(1)(a) (1988); (2) *requesting* any customer to enter into such pre-dispute arbitration contracts or agreements without first "conspicuously disclos[ing] that the execution of the contract or agreement cannot be made a non-negotiable precondition" to opening or transacting business in a securities

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[2] Under Massachusetts law, the Commonwealth's Secretary of State regulates securities matters under the Uniform Securities Act, Mass. Gen. L. ch. 110A, §§ 101 *et seq.* (1985 & Supp. 1990). See Mass. Gen. L. ch. 110A, § 406(*a*) (1985). The Secretary has delegated his regulatory authority to the Director of the Massachusetts Securities Division. See Pet. App. 6a, 61a-62a.

account, Mass. Regs. Code tit. 950, § 12.204(G)(1)(b) (1988); and (3) *requesting* any customer to enter into such pre-dispute arbitration contracts or agreements "without fully disclosing to the customer in writing the legal effect of the pre-dispute arbitration contract or clause," Mass. Regs. Code tit. 950, § 12.204(G)(1)(c) (1988).[3]

The amended regulations declared that those prohibited practices "constitute dishonest or unethical practices which are grounds for denial, suspension or revocation of registration or such other action authorized by law." Mass. Regs. Code tit. 950, § 12.204(G)(1) (1988); see Mass. Gen. L. ch. 110A, § 204(*a*)(G) (1985). In addition, Massachusetts law provides that

> [n]o person who has made or engaged in the performance of any contract in violation of any provision of [the Uniform Securities Act, Mass. Gen. L. ch. 110A, §§ 101 *et seq.* (1985 & Supp. 1990)] or any rule or order hereunder, or who has acquired any purported right under any such contract with knowledge of the facts by reason of which its making or performance was in violation, may base any suit on the contract.

Mass. Gen. L. ch. 110A, § 410(*f*) (1985).

3. On September 22, 1988, respondents, Securities Industry Association, the trade association for securities dealers, and ten brokerage firms registered to sell securities in Massachusetts, filed an action in the United States District Court for the District of Massachusetts against petitioners, the Commonwealth's Secretary of State and the Director of the Massachusetts Securities Division. Respondents challenged the validity of petitioners' arbitration regulations, alleging that Section 2 of the Federal Arbitration Act, 9 U.S.C. 2, which provides that an arbitration agreement "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or

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[3] The Secretary promulgated these regulations under his general rulemaking authority. Mass. Gen. L. ch. 110A, § 412 (1985). That state law authority was not challenged in this case.

in equity for the revocation of any contract," preempts those regulations targeted only at pre-dispute arbitration provisions. Respondents sought declaratory and injunctive relief. Pet. App. 56a-58a.[4]

4. On cross-motions for summary judgment, the district court, on December 19, 1988, declared "the Massachusetts securities arbitration regulations * * * violative of the Supremacy Clause * * *, in that they are preempted by the Federal Arbitration Act," Pet. App. 132a, and enjoined petitioners "from enforcing [those] regulations in any manner," *ibid.*

a. The district court found that "[m]andatory written pre-dispute arbitration agreements in some form are used by all [respondents]," Pet. App. 67a, that "these pre-dispute agreements do not purport to advise customers of the 'legal effects' of the arbitration clauses," *ibid.*, and that respondents "are unanimous in asserting a desire to require certain customers to agree to arbitrate disputes as a condition to opening an account," *id.* at 69a.[5] The

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[4] It was not disputed that the brokerage contracts containing arbitration agreements used by respondent brokerage firms are "contract[s] evidencing a transaction involving commerce" under Section 2 of the Federal Arbitration Act, 9 U.S.C. 2. See 9 U.S.C. 1; Pet. App. 4a, 67a n.6.

Respondents also claimed that the Commonwealth's amended regulations constituted unlawful state action in violation of 42 U.S.C. 1983. See Compl. ¶ 42, *Securities Industry Ass'n* v. *Connolly*, Civ. No. 88-2153-WD (D. Mass. filed Sept. 22, 1988). Neither the district court nor the court of appeals addressed that claim separately and thus it is not presented here.

[5] The district court noted that each respondent brokerage firm uses "arbitration agreements in its standard margin and option account contracts, with the exception of Shearson Lehman Hutton Inc., which has no arbitration clause in its option account contract." Pet. App. 68a. The court also found that six of respondent brokerage firms "do not use arbitration accounts in standard cash accounts for individuals, although one [of those firms,] Donaldson Lufkin & Jenrette Securities Corporation, does have an arbitration agreement for corporate customers." *Ibid.* And citing a recent study by the Division of Market Regulation of the Securities and Exchange Commission, the court observed that respondents' "present practice [with respect to pre-dispute arbitration agreements] appears to be

court also found that "any broker who wishes to do business in Massachusetts must observe the securities arbitration contract regulations," *id.* at 65a, since petitioners had authority to revoke the registration of any firm which engaged in the proscribed "dishonest or unethical practices," *ibid.* (citing Mass. Gen. L. ch. 110A, § 204 (1985)). Moreover, the court found that

> if a broker—or for that matter a customer—were to attempt to enforce a contract formed without compliance with the Massachusetts securities arbitration regulations, that attempt would be unavailing.

Pet. App. 66a (citing Mass. Gen. L. ch. 110A, § 410(*f*) (1985); see p. 4, *supra*). Accordingly, the court determined that those regulations "will have an immediate effect on the contracts used by broker-dealers transacting business with customers located in Massachusetts * * * by establishing additional disclosure requirements [and] prevent[ing] broker-dealers from implementing the apparently universal practice of requiring at least certain customers to enter into arbitration agreements for their disputes." Pet. App. 66a, 70a.

b. Turning to respondents' preemption claim under the Federal Arbitration Act, the district court "focus[sed] on whether the state regulations single out arbitration agreements for special treatment." Pet. App. 76a (internal quotation marks omitted). The court noted that "the fundamental purpose of the Federal Arbitration Act was to place an arbitration agreement upon the same footing as other contracts, where it belongs," *id.* at 76a-77a (internal quotation marks omitted), and that that congressional mandate was "expressly embodied in [Section 2 of the Act]," *id.* at 78a. Accordingly, Section 2 of the Act "preempts state statutory and case law that treats arbitration agreements differently from any other contract." *Ibid.* (quoting *Cook Chocolate Co.* v. *Salomon, Inc.*, 684 F. Supp. 1177, 1182 (S.D.N.Y. 1988)).

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fairly representative of the brokerage business generally." *Id.* at 69a n.7.

Petitioners conceded that the challenged regulations "single out arbitration agreements," Pet. App. 79a, but sought to avoid preemption on the ground that those regulations furthered another purpose of the Federal Arbitration Act—"the concern to implement voluntary agreements to arbitrate," *id.* at 80a. The district court rejected that contention as a "semantic sleight of hand." *Id.* at 81a. As the court explained:

> [T]he concept of voluntariness addresses the fundamental principles of contract formation upon which questions of validity, revocability, and enforceability of arbitration agreements turn. As used in that way, the concept of voluntariness is not a matter subject to idiosyncratic rules or definitions. [Petitioners are] not free under the Federal Arbitration Act to develop a definition of voluntariness applicable only to the negotiation of arbitration agreements and not to other contracts generally.
>
> That, of course, is precisely what [petitioners'] purported voluntariness enhancements do.

Id. at 81a-84a (footnote omitted).[6] The court therefore held that "[b]ecause the voluntariness concerns expressed in [the challenged regulations] impose conditions on the formation and execution of arbitration agreements which are not part of the generally applicable contract law of Massachusetts, [those regulations] cannot be given effect under the Federal Arbitration Act." *Id.* at 89a.[7]

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[6] The district court noted that "[t]here is no general contractual duty in Massachusetts requiring one party to describe fully—or for that matter, at all—the legal effect of a contractual provision to another party with whom the first party proposes to contract." Pet. App. 84a. The court also found that Massachusetts law does not impose "any general restriction requiring specific provisions to be 'negotiable.'" *Id.* at 85a.

[7] Petitioners also contended that "savings clauses" in federal securities statutes (15 U.S.C. 77r; 15 U.S.C. 78bb(a); 15 U.S.C. 80b-18a), which provide for complementary state regulation in the securities markets, show Congress's intention to permit otherwise complementary state regulation of securities arbitration provisions. The district court rejected that argument, Pet. App. 97a-98a, as did

c. Finally, the district court concluded that if its entry of summary judgment were vacated as premature, respondents were nevertheless entitled to preliminary injunctive relief. Pet. App. 106a-126a.[8]

5. On August 31, 1989, the court of appeals unanimously affirmed. Pet. App. 1a-52a. The court acknowledged that "a state law or regulation cannot take root if it looms as an obstacle to achievement of the full purposes and ends which Congress has itself set out to accomplish." *Id.* at 12a (citing cases). After reviewing this Court's recent decisions construing the Federal Arbitration Act, the court of appeals noted that "their common denominator is a principle of rigorous equality under 9 U.S.C. § 2." *Id.* at 20a. Accordingly, by virtue of Section 2 of the Federal Arbitration Act, "no state may simply subject arbitration to individuated regulation in the same manner as it might subject some other unprotected contractual device (say, a prescriptive period or exculpatory clause contained within a private contract)." *Id.* at 21a.

Petitioners conceded that the challenged regulations apply only to arbitration agreements, but claimed that those regulations were a needed means of consumer protection and thus fell outside the proscription of Section 2

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the court of appeals, *id.* at 30a-31a. Petitioners have abandoned that argument in this Court.

[8] Petitioners had filed a motion under Fed. R. Civ. P. 56(f), requesting the district court to delay its decision pending further discovery. The district court denied that motion. Pet. App. 99a-106a. As the court explained:

> The material consequences are plain here. * * * Massachusetts could not have been clearer in its intention—despite its oblique means of execution—to make securities arbitration contracts subject to different rules regarding validity and enforceability from those that govern other contracts. It takes no further factual development to reach that conclusion.

Id. at 103a-104a. Petitioners renewed that claim on appeal, but the court of appeals declined to resolve it, concluding that "the Rule 56(f) motion is * * * beside the point." *Id.* at 48a n.10. Petitioners have not sought further review of that aspect of the court of appeals' judgment.

of the Federal Arbitration Act. Pet. App. 23a-24a.[9] The court of appeals dismissed that contention, explaining that "[i]n creating a body of substantive law co[]vering arbitration, Congress barred the states from making determinations about arbitration contracts that the states remained free to make about, say, used car sales." *Id.* at 24a (citing *Perry* v. *Thomas*, 482 U.S. 483, 492 n.9 (1987)). In other words, the Federal Arbitration Act "prohibits a state from taking more stringent action addressed specifically, and limited, to arbitration contracts." Pet. App. 25a.[10]

The court of appeals acknowledged recent rules regarding pre-dispute arbitration provisions adopted by the Commodity Futures Trading Commission and the Securities and Exchange Commission that were similar to petitioners' regulations. Pet. App. 32a-33a; see pp. 18-19, *infra*. But the court pointed out the "critical distinction" that those provisions "are products of federal, not state, authority." *Id.* at 33a (citing *Shearson/American Express Inc.* v. *McMahon*, 482 U.S. at 226). The court therefore concluded that petitioners erred in relying on those federal regulatory efforts, since "Congress has not

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[9] The court of appeals noted that neither petitioners nor respondents "suggested * * * that any of the provisions [of the regulations] might be severable." Pet. App. 3a-4a. Accordingly, the court "treat[ed] them as a unit for purposes of * * * preemption analysis." *Id.* at 4a. Petitioners have maintained the same position in this Court.

[10] The court of appeals pointed out that petitioners were not powerless to remedy "a perceived problem" with respect to securities arbitration agreements. Pet. App. 25a. To the contrary, petitioners' "powers remain great, so long as used evenhandedly." *Ibid.* The court of appeals referred (*id.* at 26a) to *Perry* v. *Thomas*, 482 U.S. 483 (1987), where the Court determined that "state law * * * is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally," *id.* at 493 n.9 (emphasis in original). Moreover, the court suggested that petitioners could "pass legislation declaring all contracts of adhesion presumptively unenforceable. * * * Such a rule would apply to arbitration contracts, *among others*." Pet. App. 26a-27a (emphasis in original).

structured a similar arbitration exception for securities in general and certainly not for state regulation of securities in particular." Pet. App. 33a.

Lastly, the court of appeals rejected petitioners' argument that, since broker-dealers remained free to use pre-dispute arbitration agreements (and those agreements would be enforceable under state law), so long as broker-dealers complied with the arbitration regulations, those regulations did not contravene the Federal Arbitration Act. The court of appeals found that the regulations,

> by requiring what is not generally required to enter contracts in the Commonwealth, *e.g.*, certain negotiations, explanations, and disclosures, inhibit a party's willingness to create an arbitration contract or undermine the contract's enforceability (if the party proceeds notwithstanding the edict).

Pet. App. 38a.[11] As the Court stated in *Perry* v. *Thomas*, 482 U.S. at 493 n.9, "[a] state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with [the equality] requirement of § 2." The court of appeals therefore heeded Congress's direction in Section 2 to "foreclose state legislative attempts to undercut the enforceability of arbitration agreements." Pet. App. 41a (quoting *Southland Corp.* v. *Keating*, 465 U.S. at 16). Moreover, the court concluded that a firm's "worry that requiring a [pre-dispute arbitration agreement] might forfeit [its] ability to function as a broker-dealer at all is [also] an obstacle" to fulfilling "the federal policy to 'favor[] arbitration agreements.'" Pet. App. 43a (quoting *Moses H. Cone Memorial Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)).

DISCUSSION

This case involves the legal question whether Section 2 of the Federal Arbitration Act, 9 U.S.C. 2, precludes

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[11] Despite that express finding, in another portion of its opinion the court of appeals noted, but "express[ed] no opinion" on, Pet. App. 37a, the district court's finding that an arbitration agreement made in violation of the regulations would be unenforceable under state law. See *id.* at 66a; p. 6, *supra*.

state regulation of securities arbitration agreements to the extent those regulatory efforts subject such agreements to treatment not generally accorded other similar contractual provisions under applicable state law.[12] Although it has not squarely decided that issue, the Court has consistently drawn the distinction between impermissible state arbitration regulations that single out and subject arbitration provisions to a different enforcement regime under state law, and permissible state regulations of general application that necessarily encompass arbitration provisions in contracts. The Federal Arbitration Act bars the former regulatory efforts precisely because such state action violates the anti-discrimination principle embodied in Section 2 of the Act.

Here, the court of appeals applied the distinction drawn by this Court to hold that Section 2 preempts petitioners' securities arbitration regulations, where petitioners conceded (see, *e.g.*, Pet. App. 23a-24a, 79a) that such regulations subjected arbitration provisions to special treatment under state law. That decision is consistent with the Court's case law construing the Federal Arbitration Act and does not conflict with any other court of appeals' decision. In light of these factors, and in the absence of any indication that the decision will effectively undermine state and federal regulatory efforts to police securities arbitration provisions, we believe that further review is unwarranted.

A. 1. Under the Supremacy Clause, U.S. Const. Art. VI, Cl. 2, Congress may preempt state law in several ways. See, *e.g.*, *Fidelity Fed. Sav. & Loan Ass'n* v. *De la Cuesta*, 458 U.S. 141, 152-153 (1982). Preemption cases often present difficult questions concerning congressional intent and whether state law intrudes on a field

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[12] Petitioners discuss at length the asserted laudable policies underlying their securities arbitration regulations and point out that federal regulatory authorities appear to share that viewpoint. See, *e.g.*, Pet. 13-32, 38-40, 48-49. This case, however, raises the legal issue of whether the Federal Arbitration Act precludes petitioners' regulations, not whether those regulations are based on sound public policy. See pp. 18-19, *infra*.

occupied by Congress, inhibits accomplishment of federal purposes, or actually conflicts with federal law. This case does not. Here, Congress has provided that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. 2. The state regulations at issue purport to prohibit the formation of arbitration agreements on grounds that are applicable only to such agreements, not to "any contract." While the parties and lower courts have viewed the issue presented as one of preemption—and while that does provide a useful analytic framework—the case may be more starkly viewed as one in which the state regulations simply violate federal law. In this case it is not so much that the state has attempted to regulate a subject matter in a way that intrudes upon or conflicts with federal regulation of the same matter; rather, the state has attempted to do precisely that which federal law says it may *not* do —treat arbitration agreements differently than other contracts. This is thus a preemption case, but only in the sense that every Supremacy Clause case is a preemption case.

Section 2 of the Federal Arbitration Act "embodies a clear federal policy of requiring arbitration unless the agreement to arbitrate is not part of a contract evidencing interstate commerce or is revocable 'upon such grounds as exist at law or in equity for the revocation of any contract.'" *Perry* v. *Thomas*, 482 U.S. at 489 (quoting 9 U.S.C. 2). "In enacting § 2 of the federal Act," the Court has observed, "Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Southland Corp.* v. *Keating*, 465 U.S. at 10. "Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements." *Id.* at 16. Moreover, the Court has "see[n] nothing in the Act indicating that the broad principle of enforceability is subject to any additional

limitations under state law." *Id.* at 11; see *Perry* v. *Thomas*, 482 U.S. at 489-490.

The anti-discrimination policy embodied in the succinct language of Section 2 stems from the principal reason Congress enacted the Federal Arbitration Act—to "revers[e] centuries of judicial hostility to arbitration agreements." *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 510. As the House Report explained:

> The need for the law arises from an anachronism of our American law. Some centuries ago, because of the jealously of the English courts for their own jurisdiction, they refused to enforce specific agreements to arbitrate upon the ground that the courts were thereby ousted from their jurisdiction. This jealousy survived for so lon[g] a period that the principle became firmly embedded in the English common law and was adopted with it by the American courts.

H.R. Rep. No. 96, *supra*, at 1-2. The Act therefore "place[s] arbitration agreements 'upon the same footing as other contracts.'" *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 511 (quoting H.R. Rep. No. 96, *supra*, at 1); see, *e.g.*, *Volt Information Sciences, Inc.* v. *Board of Trustees*, 109 S. Ct. 1248, 1253 (1989). In other words, the anti-discrimination principle of Section 2 reflects Congress's considered judgment, given the historical antipathy of courts and state legislatures to arbitration, that differential state law treatment of arbitration provisions would undermine the "declared * * * national policy favoring arbitration." *Southland Corp.* v. *Keating*, 465 U.S. at 10.

2. Accordingly, in both *Southland Corp.* v. *Keating*, 465 U.S. at 16, and *Perry* v. *Thomas*, 482 U.S. at 491-493, the Court held that Section 2 preempted state law provisions which singled out certain arbitration agreements as unenforceable. As the Court explained in *Perry* v. *Thomas*:

> [S]tate law, whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability

> of contracts generally. A state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with [Section 2 and is preempted].

482 U.S. at 493 n.9 (emphasis in original). If Section 2 were construed otherwise, the Court has recognized, "states could wholly eviscerate congressional intent to place arbitration agreements 'upon the same footing as other contracts,' * * * simply by passing statutes [excepting certain arbitration agreements from the state law of contract]." *Southland Corp.* v. *Keating*, 465 U.S. at 17 n.11.

B. 1. Despite the principles described above, petitioners contend (Pet. 32-49) that the court of appeals erred in holding that the Federal Arbitration Act preempts securities arbitration regulations "that simply require disclosure and bargaining in the formation of arbitration agreements in a regulated industry," Pet. 35, where, as here, "they do not limit the ability of parties to enter into arbitration agreements, nor limit the enforcement of arbitration agreements once entered," Pet. 36. Petitioners thus seek to distinguish this case from *Perry* and *Keating*, and also take it outside the purview of the anti-discrimination principle of Section 2 of the Federal Arbitration Act, on the ground that the securities arbitration regulations do not foreclose broker-dealers from seeking (and customers from agreeing to) mandatory and enforceable pre-dispute arbitration agreements, so long as the prerequisites of the state regulations are met.

None of this Court's decisions construing the Federal Arbitration Act has specifically considered the distinction petitioners seek to draw.[13] Nevertheless, the Court

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[13] Petitioners err in relying (Pet. 41-42) on *Volt Information Sciences, Inc.* v. *Board of Trustees, supra*. In *Volt*, the Court held that the Federal Arbitration Act does not preempt application of a state law arbitration provision where the parties agreed that their arbitration agreement will be governed by that state law. As the Court explained, "[w]here, as here, the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of

has consistently determined that Section 2 of the Act preempts state law to the extent it singles out and subjects arbitration—as opposed to other contractual—provisions to a different enforcement regime under state law. See, *e.g.*, *Perry* v. *Thomas*, 482 U.S. at 491-493; *Southland Corp.* v. *Keating*, 465 U.S. at 16. Indeed, the Court has made plain that

> [a]bsent a well-founded claim that an arbitration agreement resulted from the sort of fraud or excessive economic power that would provide grounds for the revocation of any contract, * * * the Arbitration Act provides no basis for disfavoring agreements to arbitrate statutory claims by skewing the otherwise hospitable inquiry into arbitrability.

Shearson/American Express Inc. v. *McMahon*, 482 U.S. at 226 (internal quotation marks omitted).

Here, the challenged securities arbitration regulations plainly single out and subject arbitration provisions to treatment not accorded other contractual provisions under state law. Indeed, petitioners conceded as much. See, *e.g.*, Pet. 23a-24a, 79a.[14] And the record confirms that those

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the [Federal Arbitration Act], even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward." 109 S. Ct. at 1255. In *Volt*, the Court had no occasion to consider the preemptive force of Section 2, since the California law incorporated by the parties' choice-of-law provision did not purport to render the arbitration agreement unenforceable under state law. Here, by contrast, the record confirms that the challenged regulations would render mandatory pre-dispute arbitration agreements unenforceable under Massachusetts law, absent compliance with those regulatory provisions. See Pet. App. 38a, 66a; pp. 6, 10, *supra*.

[14] In passing, petitioners assert—without citation to any state law authority—that "the regulations apply conditions to the formation of securities arbitration agreements that are common to, if not the rule of, Massachusetts consumer contracts generally and securities transactions in particular." Pet. 46. That sort of vague and unsupported assertion scarcely calls into question the documented finding of the district court that "[t]here is no general contractual duty in Massachusetts requiring one party to describe fully—or for that matter, at all—the legal effect of a contractual provision to another party with whom the first party proposes to contract." Pet.

state regulations—applicable only to securities arbitration provisions—would undermine enforcement under state law of otherwise voluntary mandatory pre-dispute arbitration agreements. See Pet. App. 38a, 66a; pp. 6, 10, *supra*. The decision of the court of appeals therefore comports with the general principles enunciated in this Court's decisions construing the effect of Section 2 of the Federal Arbitration Act.

2. Moreover, the court of appeals' application of Section 2 to invalidate state regulations subjecting arbitration provisions to a different enforcement regime under state law, and consequent rejection of the distinction drawn by petitioners, does not conflict with any other court of appeals decision. To the contrary, the decision below is consistent with those decisions that have considered analogous challenges under Section 2 to state laws aimed at arbitration provisions. In *Collins Radio Co.* v. *Ex-Cell-O Corp.*, 467 F.2d 995 (8th Cir. 1972), for example, the court of appeals refused to invalidate an arbitration clause on the ground that it was unenforceable under Texas law, which required arbitration agreements to be "concluded upon the advice of counsel to both parties as evidenced by counsels' signatures," Tex. Rev. Civ. Stat. Ann. art. 224 (Vernon Supp. 1972). The court of appeals reasoned that Section 2 of the Federal Arbitration Act

> plainly voids all doctrines of invalidity, unenforceability and revocability which apply only to arbitration agreements. The plain meaning of § 2 is that federal courts are no longer to apply state statutes and decisions which limit arbitration agreements with rules not applicable to other contracts.

467 F.2d at 998 (citing cases).

App. 84a; accord *id.* at 38a (concurrent finding of court of appeals). Nor does petitioners' assertion call into question the district court's observation that Massachusetts law does not impose "any general restriction requiring specific provisions to be 'negotiable.'" *Id.* at 85a (citing *Zapatha* v. *Dairy Mart, Inc.*, 381 Mass. 284, 408 N.E. 2d 1370 (1980)); accord Pet. App. 38a (court of appeals' opinion).

Similarly, in *Medical Dev. Corp.* v. *Industrial Molding Corp.*, 479 F.2d 345, 348 (10th Cir. 1973), the court of appeals rejected a contracting party's request to hold that an arbitration provision was not part of the contract on the basis of California state law "rules applicable to arbitration agreements." The court concluded that, under Section 2 of the Federal Arbitration Act, "federal courts do not apply state statutes and decisions which limit arbitration agreements with rules not applicable to other contracts." *Ibid.*; see, *e.g.*, *Webb* v. *R. Rowland & Co.*, 800 F.2d 803, 806-807 (8th Cir. 1986) (court refuses to apply a Missouri law that requires all arbitration provisions to be accompanied by a notice, in ten point capital letters, that the contract contains such a provision); *Cook Chocolate Co.* v. *Salomon, Inc.*, 684 F. Supp. 1177, 1182 (S.D.N.Y. 1988) (citing *Perry* v. *Thomas*, *supra*, court refuses to apply New York case law that "applies the incorporation doctrine more strictly to arbitration agreements than nonarbitration agreements and requires a specific reference to arbitration within the body of the principal agreement").

Petitioners' amici (Br. 3-5) contend that the court of appeals' decision conflicts with *Supak & Sons Mfg. Co.* v. *Pervel Indus., Inc.*, 593 F.2d 135 (4th Cir. 1979). There, the Fourth Circuit held that an arbitration provision in a written confirmation materially altered the previous oral contract between the parties and thus did not become part of the contract under U.C.C. § 2-207 (1976). The court of appeals specifically noted that Section 2-207 "is * * * a general rule of contract formation" that applies broadly to all terms that materially affect the parties' expectations. 593 F.2d at 137. Here, by contrast, it is undisputed that the securities arbitration regulations, by definition, apply only to arbitration provisions. For that reason, the decision below is consistent with *Supak*.

In any event, the Fourth Circuit in *Supak* suggested that the Federal Arbitration Act "would preempt a state rule of contract formation which applied only to arbitration clauses and which placed an unreasonable burden on the parties' ability to commit themselves to arbitration."

593 F.2d at 137.[15] Of course, petitioners' regulations, which, among other things, effectively inhibit broker-dealers from requiring customers to execute mandatory pre-dispute arbitration agreements, impose precisely that sort of impermissible burden. See, *e.g.*, Pet. App. 43a. Since there is no conflict among the courts of appeals on the preemption issue presented, further review is not warranted.

C. Finally, contrary to claims raised by petitioners (Pet. 13-32) and their amici (Br. 12-15), the court of appeals' decision will not effectively undermine state and federal regulatory efforts to police securities arbitration provisions. First, the decision will not effect federal regulation in this area. As petitioners point out (Pet. 17-20), both the CFTC and the SEC—the federal agencies responsible for regulating the commodities and securities markets nationwide—have already taken steps to promote

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[15] Petitioners contend (Pet. 30-31) that the court of appeals' decision conflicts with *Saturn Distrib. Corp.* v. *Williams*, 717 F. Supp. 1147 (E.D. Va. 1989), appeal pending, No. 89-2773 (4th Cir.) (argued Dec. 6, 1989). In that case, the district court held that the Federal Arbitration Act did not preempt a Virginia law which prohibited automobile manufacturers from requiring franchise dealers to sign arbitration clauses as a condition of dealership agreements. Va. Code Ann. § 46.1-550.5:27(10) (1988). The court concluded that "[b]y ensuring consensual rather than forced arbitration, the Virginia statute is entirely in harmony with the Federal Arbitration Act." 717 F. Supp. at 1151. The court also distinguished the district court's decision here on the ground that the Virginia statute "does not single out arbitration agreements for special treatment, but rather forms an unexceptional part of the law of Virginia applicable to the formation of contracts." *Id.* at 1152.

To the extent that *Saturn Distrib. Corp.* rests on that distinction, it is not inconsistent with the decision below. On the other hand, to the extent that the purported distinction rests on a faulty premise, see 717 F. Supp. at 1150 ("an overview of the law of Virginia that governs the formation of contracts reveals that [the state law at issue] * * * affords privileged status to arbitration agreements"), *Saturn Distrib. Corp.* cannot be squared with the decision below. Nevertheless, since that case, which was decided before the First Circuit issued its opinion, remains pending before the Fourth Circuit, further review of the present case would be premature.

the efficient and fair use of arbitration provisions. Under its statutory authority to regulate dispute resolution between commodities brokers and customers, see 7 U.S.C. 7a(5), 21(b)(10), the CFTC has adopted regulations concerning the use of pre-dispute arbitration provisions. See 17 C.F.R. 180.3. Those regulations, among other things, forbid brokers from making a customer's executing a pre-dispute arbitration provision a condition for transacting business, see 17 C.F.R. 180.3(b)(1), and require brokers to disclose, in large bold-face type, the customer's rights and legal effect of an arbitration provision, 17 C.F.R. 180.3(b)(6).

Similarly, the SEC, under its statutory authority to regulate self-regulatory organizations in the securities industry, see 15 U.S.C. 78s(b), has recently approved self-regulatory organization rules requiring brokers to disclose and highlight the effects of signing an arbitration clause. Those rules, among other things, also prohibit brokers from using an arbitration clause to limit the relief available in arbitration. See *Self-Regulatory Organizations, Order Approving Proposed Rule Changes by the New York Stock Exchange, Inc., National Association of Securities Dealers, Inc., and the American Stock Exchange, Inc. Relating to the Arbitration Process and the Use of Predispute Arbitration Clauses*, 54 Fed. Reg. 21,144 (1989).[16]

Second, as the court of appeals pointed out, petitioners are not powerless to remedy "a perceived problem" with respect to securities arbitration agreements. Pet. App. 25a. To the contrary, petitioners' "powers remain great, so long as used evenhandedly." *Ibid.* Absent controlling federal law, the state legislature presumably could accomplish the goal of the securities arbitration regula-

[16] Petitioners contend (Pet. 38-39) that the federal regulatory efforts in the arbitration area confirm the sound policies (*i.e.*, consumer protection—underlying the challenged regulations at issue. That contention, however, is beside the point for purposes of resolving the preemption question presented in this case, since the actions of the CFTC and the SEC "are products of federal, not state, authority." Pet. App. 33a.

tions by enacting a state law providing, for example, that forum selection clauses in all consumer contracts must be the subject of negotiation and full disclosure. See also Pet. App. 26a-27a. In other words, application of the anti-discrimination principle of Section 2 of the Federal Arbitration Act is by no means tantamount to outlawing state regulation of arbitration provisions. Federal law simply guarantees that arbitration agreements not be singled out for special treatment. That is precisely what Massachusetts attempted to do here.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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